INDUSTRY CIRCULAR
OFFICE OF THE COMMISSIONER OF INTERNAL REVENUE
ALCOHOL AND TOBACCO TAX DIVISION
WASHINGTON, D. C. 20224

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Exclusion of State and Local Taxes in Computing Federal Tax on Large Cigars

Manufacturers and importers of tobacco products:

Purpose. This is to advise you of the enactment of Public Law 90-240 which amends Section 5701(a) of the Internal Revenue Code to provide for rounding the amount of State and local taxes in computing the tax on large cigars.

Background. The law presently provides that in determining the retail price for tax purposes regard shall be had to the ordinary retail price of a single cigar in its principal market, exclusive of any State or local taxes imposed on cigars as a commodity. A problem arises under the present bracket system when State or local cigar taxes are imposed which do not amount to an even cent. For example, when a State tax amounts to one-half cent per cigar retailers often round off the retail price of a single cigar to the next highest cent. This may cause a cigar to be subject to a higher Federal tax if the retail price of the cigar is at the top of a tax bracket.

Amendment. Public Law 90-240 amends Section 5701(a) of the Internal Revenue Code by adding after the next to last sentence the following new sentence: "For purposes of the preceding sentence, the amount of State or local tax excluded from the retail price shall be the actual tax imposed; except that, if the combined taxes result in a numerical figure ending in a fraction of a cent, the amount so excluded shall be rounded to the next highest full cent unless such rounding would result in a tax lower than the tax which would be imposed in the absence of State or local taxes."

Effect. The amendment provides, as a general rule, that in determining the ordinary retail price of a cigar in its principal market the next highest full cent may be excluded from the retail price when a State or local tax includes a fractional part of a cent. For example, a cigar which normally retails for 6 cents is taxed under the Internal Revenue Code at the rate of $4 per thousand. If a State were to impose a tax of one-half cent per cigar retailers in that State would normally round this tax to the next higher full cent and sell the cigar for 7 cents rather than 6 cents each, which after excluding the State tax of one-half cent would result in a retail price for Federal tax purposes of 6-1/2 cents. If sales in that State (or a combination of more than one State imposing such a fractional-cent tax) resulted in an ordinary retail price in the principal market of 6-1/2 cents each this would place the cigar in a higher tax bracket of $7 per thousand. In such a case after the effective date of Public Law 90-240, since the one-half cent State tax is a fractional part of a cent the amount to be excluded is rounded to the next highest full cent, thus the cigar would be taxed at the 6 cent rate even though sold at retail for 7 cents each.

The amendment also contains restrictive language to assure that no tax advantage can be realized by reason of the amended exclusion. A fractional-cent State or local tax, to be excluded in determining the price of the cigar for purposes of determining the applicable Federal tax, is not to be rounded to the next highest full cent for the purpose of exclusion if this would result in a lower Federal tax than would be imposed in the absence of the State or local tax. For example, a cigar sold only in packages of 5 at a retail price of 42 cents (8-2/5 cents per cigar) is taxed at the rate of $10 per thousand. If a State tax of one-half cent per cigar were levied on this cigar and the retail price for the 5-pack increased to 45 cents (9 cents per cigar) the rule outlined in the preceding paragraph would not be applicable in determining the Federal tax since the exclusion of the State tax rounded to the next highest full cent (one-half cent rounded to one cent) would result in an 8 cents per cigar retail price and a reduction in the Federal tax to $7 per thousand.

Effective date. Public Law 90-240 applies to removals of cigars made on and after April 1, 1968.

Revenue Ruling in conflict. Revenue Ruling 67-60 (C.B. 1967-1, 413) will be modified in respect to the exclusion of State and local taxes to conform it to the change effected by Public Law 90-240. This change will be printed in a future issue of the Internal Revenue Bulletin.

Inquiries. Inquiries regarding this circular should refer to its number and be addressed to the office of your Assistant Regional Commissioner, Alcohol and Tobacco Tax.

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